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***Via Electronic Filing***

February 22, 2012

**Ex Parte**

Ms. Marlene H. Dortch  
Secretary  
Federal Communications Commission  
445 12th Street, S.W.  
Washington, D.C. 20554

**Re: *Special Access Rates For Price Cap Local Exchange Carriers, WC***  
**Docket No. 05-25 and RM-10593**

Dear Ms. Dortch:

Many in the industry are pressuring the Commission to resolve its special access rulemaking proceeding.<sup>1</sup> While many have advocated full blown rate re-regulation, Level 3 believes that there is a considerably less drastic first step that the Commission can take in this proceeding to open the special access market to robust competition, drive price decreases through a competitive marketplace, spur innovation, create jobs and improve service delivery and quality.

Level 3 files this letter to provide a roadmap, along with its rationale, for the Commission to expeditiously address the exclusionary contracting practices imposed by price-cap local exchange carriers ("price-cap LECs") that are under examination in its special access proceeding. The Commission's existing rules do not restrain incumbent price-cap LECs, which Level 3 believes continue to have market shares for special access services in excess of 90%,<sup>2</sup> from using exclusionary and anti-competitive contracting

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<sup>1</sup> *Special Access Rates for Price Cap Local Exchange Carriers; AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, WC Docket No. 05-25, RM-10593, Order and Notice of Proposed Rulemaking, 20 FCC Rcd . 1994 (rel. Jan. 31, 2005)(*Special Access NPRM*).

<sup>2</sup> See Peter Bluhm with Dr. Robert Loube, National Regulatory Research Institute, *Competitive Issues in Special Access Markets – Revised Edition*, No. 09-02 (First Issued Jan. 21, 2009), available at

practices to minimize competition in the special access marketplace, thereby ensuring that they can reap the rewards of pricing well above competitive rates. These exclusionary practices impede the expansion of facilities-based competition into the special access market and stifle investment in competitive facilities. Level 3 believes that with the data the Commission received in its most recent *Special Access Data Request*,<sup>3</sup> current information available in the Commission's *Special Access NPRM* record and data available from other sources,<sup>4</sup> the Commission has ample data in this proceeding to determine that these exclusionary practices exist, and that they should be restricted.

## I. Introduction

The debate over special access reform is going on a decade old. The primary focus of the debate to date has been over price regulation, and that debate has been stymied by a dizzying array of arguments and counterarguments about the extent of competition, effective prices, market definitions and rates of return. There has been less focus on exploring how to generate meaningful competition where little or none exists, or, at a minimum, how to eliminate barriers to competition erected by the price-cap LECs that clearly do exist. Level 3 believes that while some level of price regulation is likely necessary, such regulation is a second best option when compared to doing what is necessary to unleash the benefits of competition and ensure the ability of carriers to compete with price-cap LECs.

Regrettably, left largely unchecked, many price-cap LECs have been able to use their market dominance to force nearly all of their major customers (many of which are also their competitors) to “lock-up” 85 to 100% of their existing special access purchases with the price-cap LEC. Such lock-up commitments eliminate the ability of competitors to compete for any meaningful share of the special access market. At the same time, the lock-up terms themselves are commercially inexplicable—unless the explanation involves the elimination of competition. The Commission de-regulated parts of the special access market based on its belief that competition would flourish, but these lock-up arrangements make that competition impossible.

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[http://nrri.org/pubs/telecommunications/NRRI\\_spcl\\_access\\_mkts\\_jan09-02.pdf](http://nrri.org/pubs/telecommunications/NRRI_spcl_access_mkts_jan09-02.pdf) (“NRRI Report”) at 41-42.

<sup>3</sup> See *Competition Data Requested in Special Access NPRM*, Public Notice, 26 FCC Rcd 14000 (Sept. 19, 2011) (“*Special Access Data Request*”).

<sup>4</sup> See e.g., United States Government Accountability Office, Report to the Chairman, Committee on Government Reform, House of Representatives, Telecommunications: FCC Needs to Improve its Ability to Monitor and Determine the Extent of Competition in Dedicated Access Services, GAO-07-80 (2006), *available at* <http://www.gao.gov/new.items/d0780.pdf> (“GAO Report”) at 30-31.

The effects of these anticompetitive practices are no longer limited to business enterprise customers.<sup>5</sup> Investment, innovation, competition and job creation in connection with construction and operation of competitive fiber networks is suppressed by these unreasonably restrictive practices. By some estimates, special access price reductions of 60% could create over 176,000 American jobs and increase US economic output by over \$37 billion.<sup>6</sup> Level 3 believes a robustly competitive special access market could even produce price reductions exceeding 60% (based on the pricing seen today in the limited competitive markets that do exist). Robust competition will increase construction of competitive fiber facilities, reduce prices and increase competitive supply of much needed special access services, and fulfill ever-increasing demand for those services so that (as only one example) wireless providers of all kinds can more efficiently use scarce spectrum to meet the needs of American consumers.

It is also worth noting that the special access market has evolved rapidly in the last decade while reform has been under consideration. Business enterprise data use is no longer the fastest growing segment of the market; instead, explosive growth in consumer broadband consumption has resulted in rapidly increasing demand for special access services in less densely populated areas of the United States.<sup>7</sup> On June 1, 2011, Cisco released its “Visual Network Index: Forecast and Methodology, 2009 - 2014” (the “Cisco VNI”).<sup>8</sup> Table 7 of the Cisco VNI provides Cisco’s forecast of overall Internet, Managed

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<sup>5</sup> Randall Stephenson, AT&T’s CEO, acknowledges that high-capacity backhaul to cell towers is the primary obstacle to the provision of broadband consumer wireless services. As Stephenson noted in an August 5, 2010 interview with Fortune Magazine: “What has been the biggest obstacle to getting the bandwidth required for iPhone penetration in a city like New York? Spectrum is important, but the No. 1 issue is getting fiber to these cell sites. That’s where the bottleneck is.” Randall Stephenson: Making Connections,” Fortune (August 5, 2010), available at [http://money.cnn.com/2010/08/04/news/companies/randall\\_stephenson\\_att.fortune/index.htm](http://money.cnn.com/2010/08/04/news/companies/randall_stephenson_att.fortune/index.htm)

<sup>6</sup> See Letter from Daniel Hesse, CEO, Sprint Nextel to the Honorable Julius Genachowski, Chairman, FCC, WC Docket No. 05-25 (filed March 15, 2011).

<sup>7</sup> See *Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993, Annual Report and Analysis of Competitive Market Conditions With Respect to Mobile Wireless, Including Commercial Mobile Services*, Fourteenth Report, WT Docket No. 09-66 (“2010 Mobile Competition Report”) at p. 17; ¶ 297.

<sup>8</sup> See Cisco Visual Network Index: Global Mobile Data Traffic Forecast Update 2010-2015, June, 1, 2011, Cisco White Paper, available at [http://www.cisco.com/en/US/solutions/collateral/ns341/ns525/ns537/ns705/ns827/white\\_paper\\_c11-481360\\_ns827\\_Networking\\_Solutions\\_White\\_Paper.html](http://www.cisco.com/en/US/solutions/collateral/ns341/ns525/ns537/ns705/ns827/white_paper_c11-481360_ns827_Networking_Solutions_White_Paper.html).

IP and Mobile Data traffic for the end of year 2015, broken down to show “consumer” versus “business” consumption.<sup>9</sup>

**Table 7: Overall Traffic Share as of Year End 2015**

	<b>Consumer</b>	<b>Business</b>	<b>Total</b>
<b>Internet</b>	66%	8%	74%
<b>Managed IP</b>	15%	4%	18%
<b>Mobile Data</b>	6%	2%	8%
<b>Total</b>	87%	13%	100%

These figures represent a dramatic shift in bandwidth consumption (towards consumers) since the passage of the Telecommunications Act of 1996 (the “Act”).<sup>10</sup> One consequence of this shift is that ordinary American consumers are among the losers paying higher prices for services as the result of a lack of effective competition in the special access marketplace.

The Commission can mitigate the effects of lock-up commitments quickly and easily. Such action would ensure affordable wired and wireless broadband services, create jobs, and stimulate competition and investment in the special access marketplace.

## **II. Discussion**

As Level 3 has highlighted in previous filings in this proceeding,<sup>11</sup> price-cap LECs sell special access almost exclusively through lock-up contracts and tariffs that require the buyer to purchase the same or virtually the same volume of special access from the price-cap LEC that it purchased in preceding periods. By preventing purchasers of special access from switching more than a small fraction of their purchases to competitive suppliers, these lock-up contracts and tariffs impede the development and deployment of facilities-based competition. Level 3 believes these practices are unjust and unreasonable, and are therefore unlawful under Section 201(b) of the Act.<sup>12</sup>

The lock-ups work through the combined effect of some or all of the following

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<sup>9</sup> While the Cisco VNI forecast is global, Level 3 believes that the same dynamic is at play in the U.S. market.

<sup>10</sup> Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996).

<sup>11</sup> See e.g., Reply Comments of Level 3 Communications, LLC, WC Docket No. 05-25, at 9-16 (filed Feb. 24, 2010); Letter from Eric J. Branfman, Counsel to Level 3 Communications, LLC to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-25 (filed Feb. 9, 2011); Letter from John M. Ryan, Assistant Chief Legal Officer, Level 3 Communications, LLC to Marlene H. Dortch, Secretary, Federal Communications Commission, WC Docket No. 05-25 (filed Aug. 20, 2010) at 1.

<sup>12</sup> 47 U.S.C. § 201(b).

practices:

- Very high “rack rates,” *i.e.*, “list prices” — which customers rarely pay;
- Large discounts from these rack rates conditioned on the customer committing 85% to 100% of their prior years’ purchases to the price-cap LEC (because the discounts are applied to such a large percentage of the service, the discounted rates effectively become the “normal” price);
- Heavy shortfall penalties if purchases fall below required levels;
- Overage penalties for *exceeding* committed purchase levels, combined with a “ratchet up” that waives the penalty so long as the additional volumes are committed to the price-cap LEC in future periods;
- Onerous circuit migration charges and restrictions which impede (a) switching to competitors, and (b) self-provisioning services over newly-constructed facilities;
- Conditioning discounts on wide geographic lock-ups that competitors cannot match and/or tying of purchases in non-competitive and potentially competitive locations;
- Providing additional discounts for shifting away from rivals, or imposing penalties for using the competition; and
- In contracts and tariffs that do not expressly contain a loyalty discount, lengthy circuit term commitments where “portability” (the ability to disconnect one circuit if another of equal or greater value is purchased to replace it) is offered only if the customer agrees to a lock-up.

The significance of the price-cap LECs’ lock-up terms cannot be overstated—they prevent facilities-based competitors from entering the multi-billion dollar special access market on a viable scale, thus preventing them from providing meaningful competition to the price-cap LECs for special access. Businesses (and investors) will not commit the substantial capital necessary to build facilities to targeted special access customers when only a small fraction of the customers’ special access demand will be available.

Proof of the effectiveness of this anti-competitive scheme is found in the fact that despite the presence of well-capitalized and aggressive rivals (including Level 3), vocally dissatisfied customers, and the passage of 12 years since the Commission deregulated special access markets, each of the price-cap LECs has maintained a market share in excess of 90% for special access lines within its region, and each has been able to price such service at levels that earn supra-competitive returns.<sup>13</sup>

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<sup>13</sup> See Comments of the Ad Hoc Telecommunications Users Committee, WC Docket No. 05-25, at Attachment B at 6 & Appendix 1 (filed Jan. 19, 2010) (price-cap LEC earnings on special access are almost \$10 billion higher than competitive level).

A Commission decision restricting price-cap LEC lock-up contracts would unleash the free market forces that the Commission predicted would make continued price regulation unnecessary in 1999.<sup>14</sup> Facilities-based competitors like Level 3 are well capitalized and well positioned to compete using existing or newly constructed facilities, and customers are on record stating that they would purchase competitors' services if not precluded by the price-cap LECs' contracts and tariffs.<sup>15</sup>

#### **A. The Commission Has Promoted and Should Continue to Promote Facilities-Based Competition**

Consistent with the ultimate goals of the Act, Commission action has aimed to foster the growth of facilities-based competition so that competition, rather than regulation, ensures that special access rates, terms and conditions are reasonable. The Commission has focused on encouraging investment in high capacity facilities to transform the local telecommunications industry from markets characterized by monopolies to markets where multiple providers compete to supply more efficient and innovative services over their own facilities.<sup>16</sup> Similarly, section 706 of the Act supports infrastructure investment and eliminating regulations that impede such investment.<sup>17</sup> This Congressional directive has been recently emboldened for high-speed communication networks.<sup>18</sup> The Commission has also focused on encouraging

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<sup>14</sup> See *Access Charge Reform*, 14 F.C.C.R. 14221, ¶¶ 1-3 (1999), *aff'd* *WorldCom v. FCC*, 238 F.3d 449 (D.C. Cir. 2001).

<sup>15</sup> See Comments of Sprint Nextel Corporation, WC Docket No. 05-25, at 30-31 (filed Aug. 8, 2007); Comments of T-Mobile USA, Inc., WC Docket No. 05-25, at 7 (filed Aug. 8, 2007); Comments in Response to NBP Public Notice #11 of PAETEC *et al.*, WC Doc. 05-25, at 30 (filed Nov. 4, 2009).

<sup>16</sup> See, e.g., *United States Telecom Ass'n v. FCC*, 359 F.3d 554, at 576 (D.C. Cir. 2004) (*USTA II*) (stating "the purpose of the Act . . . is to stimulate competition--preferably genuine, facilities-based competition."); S. Conf. Rep. No. 104-230, at 148 (1996) (explaining that "meaningful facilities-based competition" is possible in local telephone markets).

<sup>17</sup> See 47 U.S.C. § 157 (directing the Commission to take steps to increase the deployment of advanced communications networks including through the use of "regulating methods that remove barriers to infrastructure investment"); *AT&T Broadband Forbearance Order*, 22 F.C.C.R. 18705, ¶ 49 (2007) (explaining that "the directives of section 706 of the 1996 Act require that [the Commission] ensure that [its] broadband policies promote infrastructure investment, consistent with [its] other statutory obligations under the Act.").

<sup>18</sup> American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115, 516, § 6001(k).

investment in high capacity facilities and promoting competition.<sup>19</sup>

At the same time, however, the Commission recognizes that deployment of competitive facilities is a “costly and time consuming” undertaking.<sup>20</sup> Because of these high barriers, the Commission has determined that it is “unlikely that a carrier would be willing to make the significant sunk investment without some assurance that it would be able to generate revenues sufficient to recover that investment.”<sup>21</sup>

The Commission therefore concluded that “carriers generally are unwilling to invest in deploying their own loops unless they have a long-term retail contract that will generate sufficient revenues to allow them to recover the cost of their investment,” and that even “where there is adequate retail demand, the costs of constructing the loop may be sufficiently high, or there may be other operational barriers, that may deter entry.”<sup>22</sup>

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<sup>19</sup> See, e.g., *AT&T Broadband Forbearance Order*, 22 F.C.C.R. 18705, ¶ 47 (2007); *In the Matter of Connect America Fund, A National Broadband Plan for Our Future, Establishing Just and Reasonable Rates for Local Exchange Carriers, High-Cost Universal Service Support, Developing an Unified Intercarrier Compensation Regime, Federal-State Joint Board on Universal Service, Lifeline and Link-Up, Universal Service Reform – Mobility Fund*, WC Docket No. 10-90, GN Docket No. 09-51, WC Docket No. 07-135, WC Docket No. 05-337, CC Docket No. 01-92, CC Docket No. 96-45, WC Docket No. 03-109, WT Docket No. 10-208, Report and Order and Further Notice of Proposed Rulemaking, FCC 11-161 (rel. Nov. 18, 2011) (“*Connect America Fund Order*”) at ¶¶ 3-4 (redirecting universal service support to broadband investment); FCC, OMNIBUS BROADBAND INITIATIVE, CONNECTING AMERICA: THE NATIONAL BROADBAND PLAN, GN Docket No. 09-51, 47, Part I at 29 (2010) (“*National Broadband Plan*”) (stating that “Competition is a major driver of innovation and investment.”).

<sup>20</sup> *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers; Implementation of the Local Competition Provisions of the Telecommunications Act of 1996; Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket Nos. 01-338, 96-98, 98-147, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, 18 F.C.C.R. 16978 (2003), *corrected by Errata*, 18 FCC Rcd 19020 (2003), *vacated and remanded in part, aff’d in part, United States Telecom Ass’n v. FCC*, 359 F.3d 554 (D.C. Cir. 2004), *cert. denied*, 543 U.S. 925 (2004) (“*TRO*”) at ¶ 205, and that “carriers face substantial fixed and sunk costs, as well as operational barriers, when deploying loops, particularly where the capacity demanded is relatively limited.” *SBC Communications Inc. and AT&T Corp. Applications for Approval of Transfer of Control*, WC Docket No. 05-65, Memorandum Opinion and Order, 20 F.C.C.R. 18290 (2005) (“*SBC/AT&T Merger Order*”) at ¶ 39.

<sup>21</sup> *SBC/AT&T Merger Order* at ¶ 39.

<sup>22</sup> *Id.*

Thus, “for many buildings, there is little potential for competitive entry.”<sup>23</sup> Given this, to encourage facilities-based competition going forward, the Commission’s regulatory policies must abolish price-cap LEC behavior that eliminates potential demand for competitively supplied special access in large portions of the market and which impedes investment in and deployment of facilities-based competitive networks.

As demonstrated below, the Commission’s existing special access regulatory regime fails to eliminate such price-cap LEC behavior. Rather, it permits the price-cap LECs to suppress demand and facilities-based investment through anticompetitive special access lock-up arrangements. Immediate action in the Commission’s special access proceeding that eliminates the anti-competitive conduct described in greater detail below will unleash a new round of investment in competitive networks that will spur innovation and fulfill the Commission’s goal of reducing reliance on regulation to ensure that rates, terms and conditions are just and reasonable.

**B. Large Price-Cap LECs Prevent Competition and Otherwise Control the Market Through Lock-up Provisions They Impose on Special Access Customers**

**1. The Large Price-Cap LECs’ Special Access Lock-up Provisions are Exclusionary**

While the large price-cap LECs’ lock-up provisions take various forms, some or all of the following features, imposed through the price-cap LECs’ monopoly stranglehold on the market, make them exclusionary.

***Enormous “rack rates” with large discounts.*** A price-cap LEC begins with grossly inflated “rack rates,” which few customers pay.<sup>24</sup> Rack rates are set at unusually high levels only to allow a price-cap LEC to offer discounts as a condition of a lock-up.<sup>25</sup> The price-cap LEC offers large discounts (often in the range of 50%)<sup>26</sup> in exchange for a

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<sup>23</sup> *SBC/AT&T Merger Order* at ¶ 39.

<sup>24</sup> See NRRI Report at 20 (over 90% of Verizon’s special access revenue is received under discount pricing plans).

<sup>25</sup> See NRRI Report at iv (discounts range from 33% to 68%), 21 n.83 (discounts under a typical AT&T Term Pricing Plan with 5-year term receives a 53% discount off the monthly channel termination rate and slightly smaller discounts for dedicated transport, citing AT&T SBC Tariff No. 73 §§ 7.3.10(F)(1), 7.3.10(F)(10.4)(1)), 62 (table shows price-cap LEC discounts from rack rates ranging from 33-68% for channel terminations and from 7% to 68% for dedicated transport); Qwest FCC Tariff No. 1, § 7.1.3.B.2.c (Discount for Qwest Regional Commitment Program is 22%).

<sup>26</sup> These are generally presented in the form of a tariff or contract tariff. Such tariffs and contract tariffs are generally filed with the Commission on either 7 or 15 days notice, and are automatically approved if not suspended within that time.



lock-up in the range of 85% to 100% of the customer's previous year's purchases from the price-cap LEC. Individually negotiated contract tariffs are then overlaid on top of generally available tariffs, further increasing available discounts to customers willing to lock-up their demand.<sup>27</sup> Rack rates are not genuine prices that price-cap LECs intend to collect, and lock-ups therefore do not generate real discounts either; rather, they are "more accurately described as penalties that punish customers that do not buy the vast majority of their services from the price-cap LEC."<sup>28</sup>

***Commercially inexplicable discounts and terms linked to purchase commitments of up to 100%.*** While there are legitimate business justifications for selling 1,000 circuits at a lower per-unit price than ten circuits, the price-cap LECs' discounts are not derived from cost-savings based on an *absolute* measure of volume. Rather, the discounts are linked solely to the customer's past purchases. Regardless of the amount a customer purchases, the same discounts apply, so long as the customer locks up all (or nearly all) of its demand with the price-cap LEC.

There is no (legally justifiable) commercial explanation for this structure. If the discount from the rack rate is cost-justified when Customer A buys 1,000 circuits (representing 100% of its total demand), then the same discount from the rack rate should also apply when Customer B buys 1,000 circuits (even if the purchase of 1,000 circuits represents only 50% of Customer B's total demand). But the discount is not available to Customer B. To get the same discount, Customer B would need to commit to buy 2,000 circuits (100% of Customer B's demand). Discounts are thus based on the customer's commitment to buy, during the term of the lock-up contract, all or virtually all of its demand as measured by the higher<sup>29</sup> of the customer's annualized demand during the period prior to entry into the lock-up contract, or its demand during the preceding year during the lock-up contract.<sup>30</sup> For example, Verizon's Commitment Discount Plan

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<sup>27</sup> See NRRI Report at 22 (Verizon estimates additional discounts available from these overlay tariffs at 5% to 30%).

<sup>28</sup> Comments of Sprint Nextel Corp., GN Docket No. 09-51 (filed June 8, 2009) ("Sprint 6/8/09 Comments") at 29.

<sup>29</sup> See, e.g., Ameritech FCC Tariff No. 2 § 19.3(C)(2) (minimum annual revenue commitment "may be increased" based on increased purchases in prior year, "but never decreased").

<sup>30</sup> See NRRI Report at 73 (in AT&T Ameritech Discount Commitment Plan "buyers are not free to set their preferred commitment levels. A DCP buyer can commit to no less than 90% of the number of channel terminations in service when it makes the commitment, citing AT&T Ameritech FCC Tariff No 2, § 7.4.13(B)), 74 (with Term Payment Plan with portability commitment, AT&T sets the buyer's commitment level at 100% of the number of circuits the buyer currently purchases, citing AT&T SBC Tariff No. 73, § 7.2.22(E)), 74 (with Verizon Commitment Discount Plan, buyers must commit at level no lower than 90% of circuits currently purchased, citing Verizon FCC Tariff No. 11, § 25.1.3(A)(5) Qwest FCC Tariff No. 1, §§ 7.1.3.B.3.a, 7.1.4.a (commitment level is equal to 95% of monthly recurring revenue, and is adjusted upwards on monthly or

(CDP) requires the customer to commit 90% of all the channel terminations that are in-service at the time of subscription to CDP.<sup>31</sup> Verizon has stated to the FCC that “[u]nder Verizon’s CDP, a customer who purchases just 14 DS1 channel terminations from Verizon can receive the same level of discounts as larger volume customers who subscribe to the CDP for the same term of years.”<sup>32</sup> What Verizon failed to tell the FCC is that while the customer previously purchasing 14 DS1s can get a discount for purchasing 14 DS1s, the customer previously purchasing 16 DS1s (or 100 or 1000 DS1s) cannot get a discount for purchasing 14 DS1s. The discount, therefore, is not a volume discount, but, rather, a “loyalty” discount in which the customer is rewarded for buying little or nothing from competitors.

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annual basis based on increases, but not decreases, in revenue) Comments of Global Crossing North America, Inc., Docket No. 05-25 (August 7, 2007) at 9 n.15 (citing AT&T MVP Discount Plan: Must maintain 95% of baseline year’s special access spend over a 5 year term to receive a discount on special access services; Ameritech FCC Tariff 2, section 19.3(C); Pacific Bell FCC Tariff 1, § 22.3(C)(1); SWBT FCC Tariff 73, § 38.3(C); HCTPP Discount Plan: Must commit to a base level spend on dedicated T-1s, and maintain 91% of that spend over a 5 year term to receive a discount. *See* SWBT FCC Tariff No. 73, Section 7.2.20. DS1 TPP Discount Plan: Must commit to a base level of DS-1 channel terminations and maintain 80% of that level for 3 years to receive a discount. *See* PacBell FCC Tariff No. 1, Section 7.4.18. FMS/CDP discount Plans: Must maintain 90% of baseline year’s switched and special access circuits (FMS Plan) and channel terminations (CDP Plan) over a five year term to receive a discount. Verizon South FCC Tariff No. 1, Sections 6.8.26, 7.2.13, 25.1; Verizon North FCC Tariff No. 11, §§, 7.2.16(E)(3) (90% commitment level required), 25. (RCP Discount Plan: Must commit to a base level of DS1’s and DS3’s and maintain 90% of that level for 4 years to receive a discount.); Pacific Bell FCC Tariff No. 1, § 7.4.18 (with Term Payment Plan buyer’s commitment is set at 100% of circuits the buyer purchased the month before the commitment); Nevada Bell FCC Tariff No. 1, § 7.11.5.2 (same); SNET FCC Tariff No. 39, § 2.11.1.1 (with Optional Payment Plan buyer’s commitment is set at 100% of circuits the buyer purchased the month before the commitment); Verizon FCC No. 1, § 25.3.4(C)) (Verizon National Discount Plan offers discount for commitment of 85% of in service count, larger discount for commitment of 90% of in service count, and still larger discount for commitment of 92% of in service count); Verizon FCC No. 11, § 25.2.4(C) (same); Ameritech FCC Tariff No. 2 §§ 22.20.5 (requiring 100% commitment), 22.27.4(A) (commitment is 95% of average purchases over past 3 months), 22.64.4(A) (requiring 100% commitment), 22.183.5(A) (same), 22.186.5(B) (same); Pacific Bell FCC Tariff No. 1, § 33.25.4(A) (requiring 95% commitment), 33.34.4(A) (requiring 100% commitment), 33.112.5(A) (same); Southwestern Bell FCC Tariff No. 73, §§ 41.20.4(A) (same), 41.31.4(A) (same), 41.35.5 (same), 41.48.4(A) (same), 41.75.5(A) (same), 41.77.5(A) (same), 41.80.5(A) (same), 41.95.5(A) (same).

<sup>31</sup> Verizon FCC Tariff No. 1 § 25.1.3(A)(5); Verizon FCC Tariff No. 11, § 25.1.3(A)(5).

<sup>32</sup> Letter from Donna Epps, Vice President, Federal Regulatory Affairs, Verizon to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-25 (August 16, 2010) at p. 8.

In many instances, because the price-cap LECs are clever, the percentage of demand that is subject to the lockup is not obvious from the face of a contract tariff. The price-cap LECs are careful to include restrictions that *in practice* make the tariff available to only one customer, and for that customer, the required purchase volume amounts to all or virtually all of its needs. For example, Verizon Contract Option 10, Verizon FCC Tariff No. 1, § 21.11, provided a discount to any purchaser that signed up during a specified 61-day window, that purchased between \$49,000,000 and \$56,000,000 of special access during the one-year term, did not concurrently subscribe to another Verizon discount plan at the time it entered into the contract tariff or during the term of the contract tariff, plus other conditions. Thus, the price-cap LECs gerrymander the eligibility criteria of a tariff to ensure that only one purchaser can qualify, and then set the minimum volume for participating in the tariff at all or nearly all of that purchaser's existing volume.<sup>33</sup>

The price-cap LECs also use “portability” to force customers to commit all or virtually all of their demand to them. Portability clauses enable a buyer to replace a circuit that is no longer needed with one that is needed elsewhere, or an upgraded circuit at the same location. Such clauses are important because during the term of a circuit, a customer's needs may change. They may not need the circuit at the original location or they may need a different type of circuit, such as one with more capacity. As such, customers need the flexibility to disconnect an ordered circuit without incurring termination liability and replace it with something different with an equal or greater monthly recurring charge – this ability is commonly called portability. To obtain portability, however, the purchaser must agree to a lock-up—of 85-100% of the purchaser's volume.<sup>34</sup>

Much like the loyalty discounts discussed above, however, conditioning portability on a lock-up is difficult to justify on a commercial basis. When a customer

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<sup>33</sup> See, e.g., Verizon FCC Tariff No. 1 §§ 21.22, 21.42; Verizon FCC Tariff No. 11, §§ 32.26, 32.49, 32.50, 32.59; Verizon FCC Tariff No. 14, §§ 21.13, 21.21, 21.23, 21.24, 21.25 Ameritech FCC Tariff No. 2 § 22.187.3.

<sup>34</sup> Sprint 6/8/09 Comments, at 28 (stating “the Southwestern Bell, Pacific Bell and Nevada Bell DS1 term plans set the portability commitment level at 100 percent of their channel terminations provided by LEC in the month prior to the commitment; Ameritech sets the commitment at 90 percent of the in-service count,” citing SBC FCC Tariff No. 73, § 7.2.22, Pacific Bell FCC Tariff No. 1, § 7.4.18, Nevada Bell FCC Tariff No. 1, § 7.11.5.2; Ameritech FCC Tariff No. 2, § 7.4.13); *id.* (Verizon's portability commitments are between 85-100%, citing, among others, Verizon FCC Tariff No. 1, Section 25.3.1 (National Discount Plan has 85-90% commitment level for each rate element) Verizon-West FCC Tariff No. 14, Section 5.6.14 (90 percent of in-service count); Verizon-East FCC Tariff No. 1, Section 7.2.13 (100 percent of in-service DS0s); Verizon-East FCC Tariff Nos. 1 and 11, Section 25.1; Letter from Linda Vandeloop, Director, Federal Regulatory, AT&T, to Marlene H. Dortch, Secretary, FCC, WC Docket 05-25 (filed July 15, 2011), attachment (portability requires a volume commitment of 90%-100% of “current AT&T in service”).

moves or upgrades a circuit, the value to the price-cap LEC is the same (or more) following the exercise as it was before—one circuit is simply replaced with another of equal or greater value, so the LEC loses nothing. Accordingly, conditioning portability on a customer’s agreement to lock-up 85-100% of its volume makes commercial sense only because it limits competition.

***Shortfall penalties for failure to meet purchase commitment.*** A customer that fails to meet its revenue commitment is subject to severe penalties that are not reasonably related to the damages (if any) that such a failure would cause the price-cap LEC. Some penalties are so large, in fact, that they provide customers an incentive to purchase or leave in place circuits they do not even use — “channel terminations to nowhere.”<sup>35</sup>

The shortfall penalties are not mere threats. They are incorporated in price-cap LEC tariffs and vigorously enforced. In fact, Level 3 is currently making shortfall payments to one of the price-cap LECs, which demonstrates that even the largest LEC customers, notwithstanding careful planning and significant scale – and in Level 3’s case, the obvious incentive to avoid further enriching a monopolistic rival – can incur such penalties.

The competitive significance of the shortfall penalties is that, because they are so large and so vigorously enforced, they make a customer wary about buying *any* circuits from other providers or engaging in *any* self-supply, lest a miscalculation or decrease in demand throw the customer into a lower-volume condition that would trigger a penalty. Faced with the real threat of a penalty for low volume, a customer will err in the other direction and ensure that it purchases an additional “cushion” from the price-cap LEC

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<sup>35</sup> See Comments of Sprint Nextel Corp., WC Docket 05-25, at Attachment A: Declaration of Bridger M. Mitchell (filed Jan. 19, 2010) (“Mitchell Declaration”) at ¶ 129 (“under several AT&T FCC tariffs, the shortfall penalty for failing to meet a volume commitment far exceeds the rack rate of purchasing another channel termination in order to meet the commitment,” thus providing customers with “an incentive to purchase ‘channel terminations to nowhere’ simply to avoid paying the penalty”) citing AT&T Midwest (Ameritech) FCC Tariff No. 2, Section 7.4.13, AT&T Southwest (Southwestern Bell) FCC Tariff No. 73, Section 7.2.22, AT&T West (Pacific Bell) FCC Tariff No. 1, Section 7.4.18, AT&T West (Nevada Bell) FCC Tariff No. 1, Section 7.11.5.2, AT&T East (Southern New England Telephone) FCC Tariff No. 39, Section 2.11.1.1;; Comments of Sprint Nextel Corp. - NBP Public Notice #11, GN Docket No. 09-51 (filed Nov. 4, 2009) (“Sprint 11/4/09 Comments”) at 40-41 (“under several AT&T FCC tariffs, the shortfall penalty for failing to meet a volume commitment far exceeds the price of purchasing an additional channel termination in order to meet the commitment.”) citing AT&T - West (Nevada Bell) FCC Tariff 1, Section 7.11.5.2; AT&T - West (Pacific Bell) FCC Tariff 1, Section 7.4.18; AT&T - Southwest (Southwestern Bell) FCC Tariff 73, Section 7.2.20 (imposing a \$900 penalty per DS1 channel termination)., AT&T - East (Southern New England Telephone) FCC Tariff 39, Section 2.11.1.1 (imposing a rate of \$574 per channel termination).

over and above whatever it has committed. Thus, a customer with an 85% volume commitment does not really have 15% free to spend with the price-cap LEC's rivals; instead, that customer may feel compelled to purchase an additional 10% as a cushion, leaving only 5% actually available for competition. A customer with a 90% commitment may, because of the need for a cushion, have zero volume available for competition. A customer with a 100% commitment and an anticipated yearly growth rate of 10% may not make that 10% growth available for competition because it is already reserved as a cushion.

***Overage penalties for exceeding specified levels, with a “ratchet up.”*** As strange as it may sound, there are often penalties for exceeding minimum required purchases. This also makes no sense, unless one considers that the penalties are generally waived if the customer agrees to increase the minimum volume commitment to the amount actually spent in succeeding years.<sup>36</sup> This penalty/waiver procedure allows the price-cap LEC to lock-in for future years the extra volume from a customer with growing demand, who might otherwise make that volume — above the previous lock-up commitment — available to a competitor. Accordingly, if a customer spends too much money with the price-cap LEC, it must pay even more money as a penalty, unless it agrees to lock in the additional expenditure prospectively. Again, this makes no commercial sense, aside from simply limiting competition.

***Onerous circuit migration charges and restrictions.*** The price-cap LECs impose circuit migration charges that are far above cost and that appear designed to create a barrier to moving circuits to competitors. This practice is akin to charging consumers a thousand dollars to port their local telephone number to another provider. For example, Sprint informed the Commission of a \$1,125 per circuit charge by AT&T subsidiary

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<sup>36</sup> See NRRI Report at 74 (customer must pay a charge of \$900 for each channel termination in excess of 124% of commitment level purchased in each month). citing AT&T SBC Tariff No. 73, §§ 7.2.22(E)(4)(c), 7.3.10(F)(1)), 76 (“Even at discounted prices, sellers presumably recover more than their short-term marginal cost for each circuit sold. In some cases, therefore, the harm to sellers from overpurchases might be zero or even negative. Under such facts, the courts would be likely to declare a penalty provision unenforceable. . . . It is difficult to see how a seller who allows parties to relocate circuits at no cost could simultaneously claim that its capital planning needs require it to impose a large penalty for over-purchases”), 77 (where buyer overpurchases, some plans “require repeated payment of nonrecurring charges at several times the rack rate for an undiscounted service. It is hard to see how the parties could anticipate harm at this level.”); Qwest FCC Tariff No. 1, § 7.1.3B.5.c (allowing migration to other Qwest-provided services if new services have value of at least 115% of value of discontinued services); ); Comments of Sprint Nextel Corp., GN Dockets 09-47, 09-51, 09-137 (November 4, 2009) at 42 (Southwestern Bell, Nevada Bell, and Pacific Bell all assess \$900 monthly charge for each channel termination that exceeds the committed level by 24%, citing Southwestern Bell FCC Tariff No. 73, § 7.2.22; Pacific Bell FCC Tariff No. 1, § 7.4.18, Nevada Bell FCC Tariff No. 1, § 7.11.5.2; SNET’s monthly charge is \$574, citing SNET FCC tariff No. 39, § 2.11.1.1)

BellSouth,<sup>37</sup> noting that:

. . . these migration charges are assessed even if the move involves nothing more than a few keystrokes and a re-route of the circuit from one port in a central office to another a few feet away in the very same office.<sup>38</sup>

The anti-competitive nature of these charges becomes obvious when compared to the price charged for the same function, as determined by the state commissions, based on the price-cap LEC's cost studies. For example, BellSouth's rate for transferring a similar facility from one carrier to another within the same central office, as set by the Florida commission, is \$101.07.<sup>39</sup>

***Conditioning discounts on wide geographic lock-ups that competitors cannot match.*** Discounts are often conditioned on a purchaser entering into identical lock-up contracts with the price-cap LEC in widely dispersed geographic regions.<sup>40</sup> Thus, a purchaser needing circuits in both Chicago and Dallas must buy both from the price-cap LEC if it wants the discount. These provisions increase the minimum scope and scale of a prospective competitor's entry into the marketplace, since an entrant cannot compete with the price-cap LEC in either city unless it competes in both.<sup>41</sup>

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<sup>37</sup> BellSouth FCC Tariff No. 1, §§ 7.4.5(A) and (B) and 7.5.9.

<sup>38</sup> See Sprint 11/4/09 Comments, at 43.

<sup>39</sup> See Interconnection, Unbundling, Resale and Collocation Agreement between BellSouth Telecommunications, Inc. and Image Access Inc. d/b/a/ NewPhone, at 110 (filed Apr. 4, 2006), on file with Florida Public Service Commission, *available at* <http://www.psc.state.fl.us/library/FILINGS/06/03022-06/03022-06.PDF>.

<sup>40</sup> See, e.g., Ameritech FCC Tariff No. 2, §§ 22.20.1 (to receive discounts, customer is required to enter into identical lock-up contracts in four specified AT&T regions: Ameritech, Southwestern Bell, Southern New England Telephone, and Pacific Bell), 22.27.2(B) (to receive discounts, customer is required to enter into identical lock-up contracts in three specified AT&T regions: Ameritech, Southwestern Bell, and Pacific Bell) § 22.185.3(C) (to receive discounts, customer is required to enter into identical lockup contracts in all six AT&T regions); Verizon FCC Tariff No. 1, §§ 21.30(A)(2), 21.60(A) (to receive discounts, customer is required to enter into identical lockup contracts in all three Verizon regions) Verizon North, Verizon South, and Verizon West); Verizon FCC Tariff No. 11, §§ 32.32(A)(2), 32.49(C)(4), 32.55(C)(3) (same); Verizon FCC Tariff No. 14 § 21.23(C)(4).(same)

<sup>41</sup> See Comments of Sprint Nextel Corp., WC Docket No. 05-25 at p. 42 (filed Jan. 19, 2010).

***Tying of purchases in non-competitive and potentially competitive locations and tying of purchases in non-competitive and potentially competitive products.*** For large, multiple location customers – which purchase by far the largest share of the relevant services – discounts are generally not offered on a location-specific basis. Instead, they are offered only on a regional or nationwide basis, meaning that the commitments and penalties are assessed on the same wide basis.<sup>42</sup> This allows the price-cap LEC to use its ubiquity as an anticompetitive club. No CLEC can match a price-cap LEC’s geographic coverage; the CLEC can only offer competitively-priced services in a portion of the price-cap LEC’s territory – for example, let us say 15%. The multiple-location customer may wish to use the CLEC in that 15%; however, if the customer faces an 85% commitment and the prospect of shortfall penalties, it must weigh the gain from that competitive 15% of purchases against the possibility of being assessed a steep penalty for the other 85% of its purchases where it has no choice of providers. It is not surprising that the CLEC can only rarely offer a price low enough in the 15% of locations to offset the lost discounts (or risk thereof) in the other 85%.

By way of example, suppose a customer needs one circuit in location A, where there is no competition, and one circuit in location B, where competition exists. Assume further that the price-cap LEC’s rack rate price is \$1000 per circuit, but if the customer buys both circuits from the price-cap LEC, it gets a 30% discount on both circuits. (These are round numbers for sake of the example, but are representative of real world numbers.) The cost, then, of buying Circuit A from the price-cap LEC is \$1000, while the cost of buying Circuits A and B from the LEC is \$1400. The marginal cost to the customer of buying Circuit B from the price-cap LEC is thus \$400, and a competitor would have to beat this \$400 marginal cost in location B if it wants to win the customer’s business. If only limited circuits were at issue, competitors might be able to compete by reducing prices to capture incremental business. If the example is adjusted, however, to match reality, the barrier created by demand lock-ups becomes crystal clear. Assuming the same pricing and the presence of competition in 25% of locations, if a customer needs 100 circuits the math works like this:

- Rack Rate Pricing from the price-cap LEC (No Commitment to a Demand Lockup):

75 Circuits x \$1000 per circuit=\$75,000 monthly recurring charge

- 25 Circuits from CLECs **for FREE** (\$0 monthly recurring charge):

Total \$75,000 monthly recurring charge for all 100 circuits

- Discounted Pricing from the price-cap LEC (Commitment to Demand Lock-up):

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<sup>42</sup> As discussed above, when discounts are offered on a location specific basis, they either lack portability or (in Verizon’s case) include conditions on portability that impede use of portability.

100 Circuits x \$700 per circuit \$70,000 monthly recurring charge

In this second scenario, even if the CLECs ***gave away*** their circuits in the locations where they could compete, the customer is still better off committing all of its demand to the price-cap LEC.

The tying is not only geographic. The price-cap LECs also condition discounts on channel terminations, for which the price-cap LECs have the most market power, on purchases of interoffice transport from the price-cap LEC, for which the price-cap LECs have less market power. This is classic monopoly leveraging. A competitor offering only interoffice transport must match the discounts that are offered by the price-cap LEC not only on interoffice transport, but also on channel terminations. As one economist put it: “[t]hese conditions leverage the carrier’s dominance in the provision of channel terminations into greater control of the interoffice transport business, where competition is marginally more feasible.”<sup>43</sup> The object is to sacrifice some monopoly profit (via the discount) in the channel terminations market, in the short term, in order to prevent rivals from gaining a toehold in related markets that could threaten the monopoly in the long term.

***Additional discounts for shifting away from rivals, or penalties for competition.*** Finally, the price-cap LECs offer additional discounts for purchasers who can prove they migrated circuits from competitors.<sup>44</sup> The contract tariffs also provide explicit terms against competition, including revocation of the entire discount if the customer migrates more than a certain number of lines away from the price-cap LEC.<sup>45</sup>

## **2. The Lock-ups Have Broader Exclusionary Effects that Discourage Network Deployment**

In addition to the specific exclusionary effects explained above, the lock-up terms taken together have broader exclusionary effects, including the following:

***Large customers are forced to accept lock-ups even where they would prefer to use a facilities-based competitor.*** As discussed above, for multiple-location customers, discounts are generally not offered on a location-specific basis. Instead, they are offered

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<sup>43</sup> Mitchell Declaration at p. 31, ¶ 127.

<sup>44</sup> See, e.g., SWBT contract 15 ,Ameritech FCC Tariff No. 2, §§ 22.20.3(C), 22.20.5(A), 22.28.4(E)1)(a), 22.35.3(B)(2), 22.36.3(B)(2), 22.77.3(B)(4), 22.81.3(D), 22.86.3(D), §22.111.4(E)(1)(a). Pacific Bell contract 20, SNET contract 1 all require that at least 4% of services ordered from AT&T must be switched from a provider other than AT&T or its affiliates.

<sup>45</sup> See, e.g., Verizon Tariff No. 1 § 21.42(J); Verizon FCC Tariff No. 11, §§ 32.51(N), 32.59(H)(3)(b); Verizon FCC Tariff No. 14, §§ 21.21(J)(1), 21.23(J), 21.25(N).



only on a regional or nationwide basis, meaning that the commitments and penalties are assessed on the same basis.<sup>46</sup> It also generally means that restrictions will be imposed in both non-competitive (*i.e.*, where only the price-cap LEC sells services) and potentially competitive locations, allowing the price-cap LECs to again use their ubiquity as an anticompetitive club.

Faced with arrangements that tie competitive and noncompetitive services, customers know that if they want reasonable rates on routes where the price-cap LEC is their only option, they have no real commercial choice but to take the best deal offered by the only provider on those routes and thereby sacrifice the ability to obtain better rates, terms and conditions on routes where there is actual or potential competition.<sup>47</sup> For example, Sprint, a large special access purchaser, is on record as opposing the price-cap LECs' lock-up terms, and wishing to avoid them and instead to use competitive services where available. Nevertheless, Sprint has accepted lock-up terms, concluding that it has no choice. The price-cap LECs refused to offer discounts unless Sprint locked up its volume purchases, and Sprint calculated that paying rack rates "would have raised Sprint's costs 184 percent."<sup>48</sup> This differential explains why, despite wishing to preserve more of its volume for purchases from competitive sources, Sprint "reluctantly entered into another term commitment [with AT&T] to avoid the enormous cost increase."<sup>49</sup>

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<sup>46</sup> As discussed above, when discounts are offered on a location specific basis, they either lack portability or (in Verizon's case) include conditions on portability that impede use of portability.

<sup>47</sup> As Level 3 recently experienced in dealing with a substantial potential customer, such price-cap LEC plans also create artificial and inefficient barriers to the deployment of competitive facilities. A competitor such as Level 3 might offer better rates, terms, and conditions on new facilities that it would construct to a customer's location(s). But if that customer is compelled by a "requirements" plan to maintain a baseline number of circuits with the price-cap LEC, the customer will be reluctant to leave the price cap LEC's service and suffer shortfall penalties for doing so even where that customer is no longer under any term obligation with respect to individual services on the relevant routes and could otherwise "re-bid" the services. In that event, the competitive facilities to the relevant premises might never be deployed (even if a rational "build-buy" analysis would otherwise justify them) because the customer faces a substantial disincentive to depart the price-cap LEC's service. Similarly, if a wholesale carrier customer is a party to such a "requirements" agreement with the price-cap LEC, the carrier customer might feel compelled to buy services from the price cap LEC to avoid a potential shortfall rather than building to a new location. Of course, while the price-cap LEC's will undoubtedly claim that this dynamic results from a "choice" made by the wholesaler to subscribe to such a plan, such claims would once again rest upon the unproven supposition that the wholesale carrier customer had any meaningful alternative to the price-cap LEC in the first instance.

<sup>48</sup> Sprint 11/4/09 Comments, at p. 37.

<sup>49</sup> *Id.*

***Customers are forced into a choice that is, in practical terms, all-or-nothing.***

Each customer faces a choice: purchase essentially all of the relevant services from the price-cap LEC at a “discount,” or purchase from competitors in some areas and the price-cap LEC services elsewhere — but pay the price-cap LEC rack rates. The latter approach is not economically tenable and, in practice, the customer’s only real alternative if it does not want to deal with the price-cap LEC is to locate competitive suppliers that can meet all its needs, and buy nothing from the price-cap LEC.<sup>50</sup> While buying nothing from the price-cap LECs may be workable for a small minority of single-location purchasers, it is not an option in the case of nearly all multiple-location purchasers that must buy a significant portion of services only served by the incumbent. Thus, the price-cap LECs’ market power forces purchasers to accept provisions “tying access to those circuits that are only available from the incumbent (the tying product) to the portion of the [customer’s] demand that could be fulfilled by competitive providers (the tied product).”<sup>51</sup>

***With customers forced into the “all” (or nearly all) or “nothing” (or nearly nothing) choice, facilities-based competitors cannot attain minimum viable scale on a building, area, and/or regional basis.*** The price-cap LECs’ lock-ups build a wall around the customer’s purchases, preventing rivals from obtaining enough business to enter or, where already present, to grow to the point of threatening the price-cap LEC’s monopoly. The result is that competitors cannot attain the minimum viable scale for entering particular markets — whether they are buildings, metropolitan areas or regions. As stated by one economist, “[l]ess than fully exclusive contracts can . . . be exclusionary where they tie up sufficient volume to prevent smaller competitors from achieving minimum viable scale.”<sup>52</sup>

This problem of scale is particularly acute where, as is often the case, CLECs require access to price-cap LEC transmission facilities as a transitional “bridge” mechanism.<sup>53</sup> It generally is not economical for a CLEC to build transmission facilities

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<sup>50</sup> As the GAO concluded, “[u]nless a competitor can meet the customer’s entire demand, the customer has an incentive to stay with the incumbent and to purchase additional circuits from the incumbent, rather than to switch to a competitor or purchase a portion of their demand from a competitor—even if the competitor is less expensive.” GAO Report, at 30.

<sup>51</sup> Comments of Time Warner Telecom and One Communications, WC Docket No. 05-25, at 37 (filed August 8, 2007).

<sup>52</sup> Reply Comments of WorldCom, Inc., RM-10593, Attachment A: Declaration of Michael D. Pelcovits on Behalf of WorldCom Inc., at 7 (filed Jan. 23, 2003).

<sup>53</sup> AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services, RM-10593 (October 15, 2002) (“AT&T 2002 Petition”). at 16.

from a backbone into a building “on spec.”<sup>54</sup> The CLEC needs to obtain a customer’s assurance of a contract that is long enough and high-volume enough to recoup at least a portion of the connection expenses,<sup>55</sup> and even then, it is often economical to serve the first customer in a particular building or area only by using a combination of CLEC and price-cap LEC connections rather than waiting for the completion of a newly constructed CLEC network. After the first customer is established, each subsequent customer in the building or area becomes more economical for the CLEC, and soon the CLEC can provision over network that it fully owns, making the price-cap LEC services unnecessary. But a demand lock-up imposed on the CLEC may impose substantial penalties for the cancellation of these circuits, thus making it more difficult to use a price-cap LEC “bridge” as a tool to reach full competition. The price-cap LECs clearly recognize this and try to prevent it through offering all-or-nothing terms.

***The lock-ups permit the price-cap LECs to retain customers despite pricing above CLECs’ costs.*** The price-cap LECs may claim that they are simply beating the CLECs on price; however, the evidence establishes that this is not the case. Instead, lock-ups allow price-cap LECs to charge prices that are “well above a competitive carrier’s cost, [but] the competitor will nevertheless find it unprofitable to enter on a small scale, because the customer is penalized on its infra-marginal price-cap LEC business for giving marginal business to the competitor.”<sup>56</sup> As economist Dr. Joseph Farrell explained:

It is a tempting fallacy to think that optional discount plans cannot be harmful simply because customers select them voluntarily. The claim that voluntary discounts cannot harm consumers assumes that the basic month-to-month rates [rack rates] are not affected, but in fact, once [a price-cap LEC] has contracted with some of its customers for a percentage discount off the month-to-month tariff, it has an incentive to raise the latter above the level that it would have chosen otherwise. In the longer term, exclusionary contracts can be expected to harm competition and customers, whether or not they decrease prices in the short run.<sup>57</sup>

Further, other economists retained by Sprint have recently concluded that:

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<sup>54</sup> AT&T 2002 Petition at 16.

<sup>55</sup> Level 3 does not oppose volume commitments where necessary to recoup specific investments and sunk costs. The price-cap LECs’ lock-ups, however, are not tied to such sunk costs. In fact, the commitments are often “portable” from one location to another and even from one entire geographic region to another, proving that they are not linked to or justified by specific building-by-building capital investments.

<sup>56</sup> Reply Comments of CompTel *et al.*, WC Docket No. 05-25, at Attachment: Reply Declaration of Joseph Farrell on Behalf of CompTel (filed July 29, 2005) (“Farrell Reply Declaration”), at 7, ¶ 16.

<sup>57</sup> Farrell Reply Declaration at 8-9, ¶ 21, 2005 Reply Comments of CompTel.

... over the last ten years, a variety of studies have concluded that special access services produce excess rates of return as high as 77.9%. By contrast, the FCC's last authorized rate of return was 11.25%. In addition, prices for special access services are well in excess of the prices for unbundled network elements and fiber-based broadband services that offer similar speeds. In light of this significant disparity, a number of researchers have argued that special access rates should be significantly reduced. It is suggested that if special access rates were cut substantially, the beneficial effects of those reductions would be felt not only by the direct purchasers of special access but also by other businesses and their workers in other sectors of the U.S. economy.<sup>58</sup>

It is unthinkable that the price-cap LECs could have maintained the market shares that they have, in a robustly competitive market while pricing the way that they have.

***The lock-ups prevent Level 3 from self-provisioning or using CLECs' services.***

For firms that are not only customers but also rivals or potential rivals of the price-cap LECs – meaning they have the technological capacity to self-provision or compete with the price-cap LECs at least in some areas – there is an additional anticompetitive effect of directly preventing the rival from offering competitive services. This is best illustrated with Level 3's experience. Over the past 9 years, Level 3 has purchased 8 carriers that purchased special access from the price-cap LECs.<sup>59</sup> In each case, Level 3 was able to determine that these carriers were, prior to being purchased by Level 3, prevented from self-provisioning or purchasing from other CLECs by their price-cap LEC lock-up contracts. And in each instance Level 3 was constrained in its ability to cancel unneeded circuits or move circuits to its own more efficient, less costly network because of (a) demand lock-ups, (b) portability restrictions, and/or (c) cumbersome and costly circuit migration rules imposed by price-cap LECs.

**C. Price-cap LECs' Arguments that Their Lock-up Provisions are Not Exclusionary or Otherwise Anticompetitive Lack Merit**

Price-cap LECs have argued that the special access market is highly competitive. These arguments are not well-founded.

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<sup>58</sup> See Letter from Sprint CEO Daniel Hesse to the Honorable Julius Genachowski, Chairman, dated March 15, 2011 (Attachment).

<sup>59</sup> Purchased companies or portions of companies that bought special access from the price-cap LECs include Genuity, ICG Telecom, WilTel, Progress Telecom, Telcove, Looking Glass, Broadwing and Global Crossing.

**1. The Price-cap LECs' Argument that Lock-Up Provisions are Permissible Because They Offer Special Access Services without Lock-Up Provisions is Specious**

The price-cap LECs argue that they offer special access arrangements that “do not restrict customers’ ability to obtain high capacity services from ... competitors or from supplying the facilities themselves.”<sup>60</sup> This argument is specious because the price-cap LECs fail to provide any evidence there is much demand for unrestricted “rack rate” offerings in comparison to the offering with lock-up provisions. Indeed, while such non-lock-up offerings may be available, the demand is likely small when compared to the price-cap LECs’ special access offerings that come with lock-up provisions.

In certain instances, Verizon makes portability or upgrades available without a volume commitment. *E.g.*, Verizon FCC Tariff No. 1, Sections 7.4.13(C) and 7.4.17(E)(3) and (4) and Verizon FCC Tariff No. 11, Section 7.4.10 (C)). Level 3 has likewise found that the portability clauses provided in such tariff provisions are very difficult to use in practice because substitution of circuits must be done on an order for order basis, in which the customer must reference the disconnected service on its new order at the time it is placed and the orders must be linked in time (within 60 or 90 days). The result is that there is delay in both installing new circuits and disconnecting old circuits. The upgrade options do not allow conversion to an Ethernet service, a newer technology that is increasingly in demand, and although some tariffed “technology migration options” (*e.g.*, Verizon FCC Tariff No. 1, § 2.9) allow a change in technology, there are numerous restrictions, including length of commitment requirements, bandwidth requirements, revenue test requirements, terminating location requirements, timing requirements, and notification requirements that make this option very difficult to use. In addition, there is a 90 day advance notice requirement for disconnection of a DS-3. *See* Verizon FCC Tariff No. 1, Section 7.4.13D. Level 3 is not aware of any comparable provisions in AT&T’s or Qwest’s tariffs.

While the responses to the FCC’s *Second Data Request Public Notice* should provide further evidence to show how few large purchasers of special access are able to avoid lock-up contracts and tariffs, the FCC has yet to allow the public to review the responses submitted to the FCC’s first and second data requests, even by Level 3’s outside attorneys. Even without reviewing these responses, in all events, Level 3 knows that (1) its own very substantial special access purchases are subject to such lock-up contracts; (2) many other large purchasers of special access – in particular, Sprint and T-

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<sup>60</sup> Letter from Jeffrey S. Lannin, Assistant Vice President, Federal Regulatory Affairs, CenturyLink, to Marlene H. Dortch, Secretary, FCC WC Docket No. 05-25, TM-10593, at 1 (filed July 22, 2011). *See* Letter from Donna Epps, Vice President, Federal Regulatory Affairs, Verizon, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-25 and RM-10593 (filed July 14, 2011); Letter from Linda Vandeloop, Director, Federal Regulatory, AT&T, to Marlene H. Dortch, Secretary, FCC, WC Docket 05-25 (filed July 15, 2011).

Mobile, which are likely the two largest non-price-cap LEC purchasers of special access – have complained of being forced to enter into such lock-up contracts; and (3) when Level 3 has sought to sell special access to other large purchasers, it has generally been informed that the prospective purchaser would very much like to avail itself of Level 3’s lower prices and higher quality in those locations where Level 3 is prepared to offer special access, but is precluded from doing so by the price-cap LECs’ lock-up contracts.

Level 3 also wishes to set the record straight in response to the highly misleading assertion of AT&T that “A review of Level 3’s special access purchases from AT&T, for example, confirms that AT&T’s contracts provide Level 3 flexibility to shift a very large percentage of its demand to alternatives, and thus do not “lock-in” Level 3 to obtaining special access only from AT&T.”<sup>61</sup> Prior to AT&T’s merger with BellSouth, Level 3’s recently acquired subsidiary Broadwing Communications, LLC (“Broadwing”) was subject to a lock-up contract with AT&T that required it to purchase the vast majority of its circuits in AT&T territory from AT&T. After AT&T merged with BellSouth, a dispute arose between AT&T and Level 3 (Broadwing) over AT&T’s compliance with the FCC merger conditions related to special access. Level 3 filed a Formal Complaint against AT&T at the FCC. The Complaint was dismissed as the result of a settlement.<sup>62</sup>

As the result of a confidentiality agreement, Level 3 is not at liberty to summarize the settlement. However, AT&T publicly filed a contract tariff<sup>63</sup> the same week as Level 3 dismissed its Complaint. By availing itself of the contract tariff, Level 3 has been able to move some of its circuits off of AT&T’s network, though it is still in a commitment large enough that it restricts Level 3’s ability to freely purchase from competitors everywhere it wants. The circuits migrated away from Level 3 are now either on Level 3’s own network or on networks of other CLECs. In either case, Level 3 is obtaining them at a lower price than it could from AT&T.

The unique circumstance of Level 3’s current contract tariff arrangement with AT&T provides an opportunity for comparison, both from a time-specific perspective and from a cross section perspective. After the settlement, Level 3 was able to improve optimization of its purchases by moving circuits to competitive sources at lower prices. Similar savings have not been achieved in Level 3’s relationships with Verizon and Qwest during the same time frame. Level 3 is better able to optimize its purchases by filling a larger portion of its demand from lower-priced competitive suppliers in AT&T territory than it is in Verizon or Qwest territories.

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<sup>61</sup> Letter of Christopher M. Heimann, General Attorney, AT&T, to Ms. Marlene Dortch, Secretary, WC Docket 05-25 (filed March 7, 2011), n. 19

<sup>62</sup> In the Matter of Broadwing Communications, LLC, Complainant, v. AT&T, Inc. *et al*, Defendants, Order of Dismissal, File No. EB-07-MD-005(rel. April 2, 2009).

<sup>63</sup> SWBT FCC Tariff No. 73, § 41.162

To Level 3's knowledge, no other purchaser of special access circuits from AT&T has the contractual capacity to reduce its use of AT&T special access services by such an amount. Therefore, while Level 3 is presently in a better position in its role as a *customer* of AT&T, it is not in a better position in its role as a *competitor* of AT&T, because prospective purchasers from Level 3 continue to be saddled with restrictive lock-ups that preclude them from buying much of their needs in AT&T territory from any entity other than AT&T. For the same reasons, the competitive process in the AT&T territory continues to suffer significant harm by reason of AT&T's lock-up contracts.

## **2. The Price-cap LECs' Efficiencies and Business Justifications Are Weak and Do Not Excuse Their Exclusionary Conduct**

The price-cap LECs are also likely to argue that their lock-up conditions are cost- and efficiency-based, on two related grounds: (1) Their volume discounts merely reflect the commonplace fact that it is less costly on a per-unit basis to provide a large volume of units than to provide a small volume; and (2) They need predictability about next-year volume in order to allocate their supply resources efficiently, and the volume commitments and penalties are a reasonable way to gain that predictability. As a general or theoretical matter, both arguments have intuitive appeal; however, both are belied by the price-cap LECs' actual terms and actual practices. Paraphrasing the Third Circuit Court of Appeals in the *Dentsply* case, the price-cap LECs' alleged justifications for their exclusionary policies are inconsistent with their conduct in enforcing those policies and their customers' actual behavior in the marketplace; as a result, their justifications should be set aside.<sup>64</sup>

As an initial matter, the price-cap LECs' "cost- and efficiency-based" arguments in support of their discounts ring hollow. As explained, the discounts are not actually based on volume, as the term "volume" is generally understood (i.e., they are not based on an absolute volume that might be linked to a bulk-related cost savings on the supply side). Rather, they are based on a percentage of prior spend commitment. As Sprint has observed,

. . . the BOCs' "discounts" do not appear to be based in any way on their own cost structure (i.e., the savings the BOCs realize by providing services in bulk). The volume "discount" is based on the subscriber's commitment rather than the size of its total demand.\* Thus, such a discount plan appears to be driven more by the BOCs' desire to limit customers' purchases from competing providers than by the savings involved in serving larger volume customers.

For example, an AT&T customer with \$10 million in total annual special access purchases would have to purchase \$9.5 million worth of those requirements (95 percent) in

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<sup>64</sup> See *United States v. Dentsply Int'l, Inc.*, 399 F.3d 181, 196-97 (3d Cir. 2005).

order to be eligible for the volume discount. Another AT&T customer, with \$100 million in annual purchases, would have to purchase \$95 million worth of services to obtain the same percentage discount.<sup>65</sup>

The price-cap LECs do not publish a single level (or even a handful of levels) at which discounts apply. Rather, they issue a byzantine series of tariffs that either (a) remain open but require high commitment percentages, or are tailored to individual customers or (b) remain open to subscription only for short periods of time, and require that the customer lock-up the vast majority of its purchases. Sometimes, in the case of the targeted, short-duration tariffs, the commitment level necessary for the discount is stated as an absolute number; however, those absolute numbers vary widely from tariff to tariff and appear merely to be firm measurements that we believe are equivalent to nearly 100% of a targeted customer's known spend. It is impossible to believe that the price-cap LECs' cost structures can vary so widely between customers, and can change so quickly that a tariff must remain open for only (in a typical term) thirty to sixty days. In addition, there are tight constraints around matters such as the minimum and maximum dollars that the purchaser is currently spending for circuits that are Direct Trunked transport<sup>66</sup> that appear to serve no purpose but to exclude other potential purchasers. As discussed above, the discounts are not linked to standardized absolute volume levels and cannot be explained by cost or commercial factors alone.

The price-cap LECs' "predictability" justification for high percentage commitment levels also fails because it conflicts with their actual cost structure and practices. In theory, a firm may be justified in asking customers to commit to certain levels of purchases, where those purchases are used to support infrastructure investments or similar sunk costs by the supplier. But in practice, the price-cap LECs have not shown that commitment levels are necessary to support their investment and they cannot do so. Most of these circuits already exist (and were already paid for by the captive ratepayers through rate of return-based, regulated investment recapture), and the 85% to 100% commitment levels appear to be far higher than necessary to capture any incremental costs. Moreover, the price-cap LECs permit "portability" such that a customer is free to strand the price-cap LEC's investment by moving the volume to a location in another building, or even another geographic region (for example, from Los Angeles to Chicago, in AT&T's case). Allowing portability is inconsistent with an alleged desire for predictability. The only thing "predictable" here is that the customers will not be allowed to buy much of their special access needs from a CLEC, a cable company, Verizon or AT&T out of their territories, or any other alternative supplier of such service.

Moreover, Qwest fairly recently increased the amount of its lock-up percentages. On July 1, 2010, Qwest raised its commitment level from 90% to 95%.<sup>67</sup> This does not

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<sup>65</sup> Sprint 6/8/09 Comments at 39, n.79.

<sup>66</sup> E.g., Verizon FCC Tariff No. 1, § 21.11.

<sup>67</sup> Qwest FCC Tariff No. 1, §§ 7.1.3.B.3.a



coincide with a suddenly-realized increased need to predict Qwest's volume utilization for internal planning purposes – that need, such as it is, has not increased, and in fact one would expect to find that it has declined as the cost of such services has declined. Instead, the increase coincides with increased threat of competition from Level 3 and other CLECs, and is likely explained as an anticompetitive response to that factor.

In addition, AT&T has moved to eliminate generally available tariffs, such as its Managed Value Plan and its BellSouth Transport Advantage Plan,<sup>68</sup> that provide overarching discounts that do not need to be individually negotiated. This forces customers into individual negotiations that AT&T may then customize to ensure maximum commitment terms.

### **3. Potential Competition Does Not Constrain the Price-cap LECs' Exclusionary Behavior**

The price-cap LECs have argued that rivals have the technical capacity, experience, capitalization, and reputation necessary to supply a large percentage of special access volume, even where they have not deployed facilities, and that this potential competition constrains the price-cap LECs' behavior and renders the market competitive notwithstanding their current dominance.<sup>69</sup> Rivals do not currently constrain the price-cap LECs' power in the real world, nor is there any prospect of them doing so in the foreseeable future, so long as the lock-ups remain in place.

There are significant barriers to entry in this market. Such barriers include physical barriers, such as rivers and rail beds between the competitor's network and the customer's location, and the need for consents from building owners and municipal officials.<sup>70</sup> These barriers impose costs that result in the deployment of even a single

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<sup>68</sup> *E.g.*, Pacific Bell FCC Tariff No. 1, § 22.1 (providing that MVP discount plan is not available to new customers and existing customers may renew pursuant to § 22.3), § 22.3(F) (limiting customer to one renewal); BellSouth FCC Tariff No. 1, § 2.4.8(H) (providing that “effective November 15, 2007, the BellSouth Transport Advantage Plan (TAP) will no longer be available for new customer subscriptions. Customers with an existing TAP may keep the TAP under the terms and conditions specified herein until the term of the TAP expires.”). In addition, although AT&T committed as a condition to the BellSouth merger not to raise prices before July 1, 2010, on June 2, 2007, it filed a tariff pre-announcing price increases as of that date more than 3 years in advance, (*see* Exhibit 3 to Declaration of Susan M Gately, Appendix 2 to Comments of the AdHoc Telecommunications Users Committee, WC Docket No. 02-25 (Aug. 8, 2007).

<sup>69</sup> *See, e.g.*, Comments of Verizon and Verizon Wireless, WC Docket 05-25, at 19-29 (Jan. 19, 2010).

<sup>70</sup> *See* AT&T 2002 Petition at 31 (contrasting the high transaction costs that a CLEC incurs in obtaining rights-of-way from local governments with the “minimal transaction costs” that the Bells incurred as “first movers.”).

connection costing tens or hundreds of thousands of dollars, and as a result facilities-based competitors will typically build to a particular building “only after they have secured a customer contract of sufficient size to justify the anticipated construction costs for that building.”<sup>71</sup>

There is widespread recognition of the barriers to entry in special access.<sup>72</sup> As discussed in Section II above, the Commission likewise found that there are significant barriers to loop deployment, including significant sunk costs.<sup>73</sup> The NRRI Report, for example, concluded that the revenue that a competitor could obtain by selling a DS-1 that required construction of 1/4 mile of network would be only 4% of the revenue needed to recoup the cost of construction, even if the competitor could find buyers at the price-cap LEC’s rack rate prices.<sup>74</sup>

Because large customers typically need connectivity among large numbers of locations, the price-cap LECs gain leverage from ubiquity that is unavailable to competitors.<sup>75</sup> For example, “a bank may have 30 or 40 locations in 12 states in one region of the country that require dedicated access. To serve that customer wholly over its own facilities, a competitor would need to extend its network to all of those locations.”<sup>76</sup> Because the percentage of buildings in the MSAs examined with a competitor “appears to be relatively small, it is unlikely that a single competitor would have very many of its own facilities to serve such a customer.”<sup>77</sup> The obvious solution would be for the competitor to build its own facilities to those of the 30 or 40 locations

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<sup>71</sup> Complaint, *United States v. SBC Comm., Inc. et al.*, No. 1:05-cv-02102-EGS, (D.D.C. October 27, 2005) and Complaint, *United States v. Verizon Comm. Inc.*, No. 1:05-cv-02103-EGS (D.D.C. October 27, 2005) (“United States’ RBOC Merger Complaints”), at ¶ 28.

<sup>72</sup> GAO Report, at 26-27; NRRI Report at 54-55; *Unbundled Access to Network Elements, Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, WC Docket No. 04-313, CC Docket No. 01-338, Order on Remand, 20 F.C.C.R. 2533, (2005), *aff’d*, *Covad Commc’ns Co. v. FCC*, 450 F.3d 528 (D.C. Cir. 2006) (“*TRRO*”) at ¶¶ 150, 152-53.

<sup>73</sup> See *TRRO*, ¶ 150.

<sup>74</sup> NRRI Report, at 54. See also Reply Comments of AT&T Corp, RM-10593, at Exhibit 3: Reply Declaration of Janusz A. Ordovery and Robert D. Willig, ¶ 29 (filed Jan. 23, 2003) (deployment of transport facilities to a particular point of aggregation (Local Dedicated Interoffice Circuits) is only economic when there are at least 18 DS-3s of traffic available).

<sup>75</sup> See Comments of the Ad Hoc Telecommunications Users Committee, WC Docket No. 05-25, at Attachment A: Declaration of Lee L. Selwyn, ¶¶ 2-8 (filed Jan. 19, 2010).

<sup>76</sup> GAO Report, at 23.

<sup>77</sup> *Id.*

that it could reach economically, and lease facilities to serve the others from the price-cap LEC. To defeat such an approach, as demonstrated in section II.B.1 above, the price-cap LECs effectively require purchasers to fulfill either nearly all their special access needs from the price-cap LEC or nearly none.

#### **4. Alternative Forms of Competition Are Nonexistent and Do Not Otherwise Constrain the Price-cap LEC's Exclusionary Behavior**

The price-cap LECs have pointed to the purchase by CLECs of high capacity circuits as unbundled network elements (UNEs).<sup>78</sup> The argument that UNEs are equivalent to special access circuits is contradicted by the price-cap LECs' service level agreements,<sup>79</sup> which are applicable to special access circuits, while UNEs lack comparable guarantees. Moreover, under the Commission's unbundling rules, DS-1 and DS-3 UNEs are not available in many locations,<sup>80</sup> or to wireless carriers,<sup>81</sup> a growing segment of the market. In addition, the price-cap LECs' special access tariffs offering discounts have "access service ratios" of 95%, which means that if the purchaser wants to use special access (for example in locations where UNEs are not available, or where a customer requires a service level agreement), it must buy 19 special access circuits for each UNE it buys; otherwise, it must pay rack rate for all of its special access circuits.<sup>82</sup>

Likewise, the resale of price-cap LEC special access services is also an ineffective source of competition in the special access marketplace. The Department of Justice has recognized that resale of special access purchased from the price-cap LECs "would not be effective as a competitive constraint" because the price-cap LECs "would control the price of the resold circuits."<sup>83</sup>

While there may be some possibility that cable and fixed wireless are effective substitutes for special access, as the price-cap LECs claim, there are a number of significant issues with such claims.<sup>84</sup> First, such services do not generally meet the performance and reliability standards for special access and are not available at most

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<sup>78</sup> See Letter from Christopher A. Heimann, General Attorney, AT&T Services, Inc., to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-25, at 6 (filed Mar. 7, 2011).

<sup>79</sup> See, e.g., Verizon FCC Tariff No. 1, § 2.7.3.

<sup>80</sup> See Reply Comments of Nextel Communications, Inc., WC Docket No. 05-25, at 20 n.70 (filed July 29, 2005).

<sup>81</sup> See 47 C.F.R. 51.309(b) (denying access to UNEs for the exclusive provision of mobile wireless); *TRRO*, ¶ 34 (same).

<sup>82</sup> See NRRI Report, at 78-79.

<sup>83</sup> United States' RBOC Merger Complaints, at ¶ 25.

<sup>84</sup> See e.g., *Comments of Verizon on the Data Requested for Special Access Notice of proposed Rulemaking*, WC Docket No. 05-25 (filed Jan. 27, 2011) at 4; *Comments of Verizon and Verizon Wireless*, WC Docket No. 05-25 (filed Jan. 19, 2010) at 20-27.

locations.<sup>85</sup> Second, while these providers frequently offer Ethernet service, they do not generally offer TDM service at the DS-1 and DS-3 level, which constitutes the majority of current demand. Third, and most importantly, even if cable and fixed wireless offerings were available as a substitute for special access, the existence of the demand lockups in price-cap LEC contracts makes it difficult for customers to use those alternatives for anything more than a small percentage of their needs. In other words, cable and fixed wireless competitors face the same barrier to competing effectively in this market as fiber-based competitors such as Level 3—if the Commission does not address the price-cap LECs’ anticompetitive lock-ups, there will simply be more competitors sharing the small piece of pie subject to competition.

#### **D. Suggested Relief and Possible Commission Action**

As discussed above, pursuant to Section 201(b) of the 1996 Act, the Commission must ensure that prices, terms and conditions contained in filed tariffs are “just and reasonable.”<sup>86</sup> Level 3 believes that the lock-up commitments discussed above violate Section 201(b), and that the Commission can and should take steps to address these anticompetitive practices and to preserve the Commission’s ability to fulfill the basic objectives of the *National Broadband Plan*.<sup>87</sup> Below, Level 3 suggests six remedies the Commission should employ on an expedited basis to eliminate monopolistic lock-up contract provisions:

1. Immediately preclude any price-cap LEC from offering, directly or indirectly, in any new contract tariff or tariff discount plan: i) a discount, rebate or any other form of price concession, or ii) any other commercial term(s) or condition(s) in exchange for a customer’s commitment to purchase more than 50% of the amount spent on special access services in the previous year.
2. With respect to existing contract tariffs and tariff discount plans containing commitments that would violate the prohibition above, such plans must be immediately amended to reflect commitments that are no greater than the maximum percentage permitted by the Commission.
3. Immediately preclude price-cap LECs from including any term or condition in a contract tariff or tariff discount plan that has the effect of preventing other customers that purchase a similar or greater volume of like services from obtaining the same price terms, such that pricing is available to similar or greater volume customers for a minimum period of one year from the effective date of the contract tariff or tariff discount terms.

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<sup>85</sup> See Reply Comments of Nextel Communications, Inc., WC Docket No. 05-25, at Attachment 1: Declaration of Bridger M. Mitchell and John R. Woodbury at 11-12 (July 29, 2005); Letter from Thomas Jones, Counsel to tw telecom inc., to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-25, at 17-18 (filed July 9, 2009).

<sup>86</sup> 47 U.S.C. § 201(b).

<sup>87</sup> See *National Broadband Plan*, Chapter 2 at 7-12.

4. Immediately preclude price-cap LECs from including (in any new contract tariff or tariff discount plan) any volume purchase commitment that extends for a period of more than one year (but permit terms that allow a customer to renew its service at the end of the year with a new volume commitment).<sup>88</sup>
5. Immediately preclude price-cap LECs from requiring (in any new contract tariff or tariff discount plan) payment of termination penalties, respecting any commitment and/or respecting any circuit, that are in excess of the costs incurred by the LEC as the result of the early termination.
6. Immediately preclude price-cap LECs from imposing special access circuit migration charges that are in excess of cost.

Importantly, Level 3 does not view these matters as independent from the Commission's obligation to assure that just and reasonable rates are charged for special access services. If the primary consequence of any elimination of onerous commitments and terms is an effective increase in price-cap LEC prices where there is no competitive alternative, the Commission's mandate under section 201(b) of the act, and the objectives of the *National Broadband Plan*, will be thwarted. Thus, as a protective measure, the Commission should require that price-cap LECs maintain current discount levels and other lock-up term benefits contained in discount plans or contract tariffs, notwithstanding the expiration, elimination or revision of the demand lock-up provisions contained in those tariffs. In addition to this requirement, the Commission should institute a speedy enforcement process for any price-cap LEC special access customer that demonstrates that, as a result of elimination of onerous purchase commitments, its effective rates for monopoly price-cap LEC special access services have increased in violation of the foregoing.

## **E. Conclusion**

Commenting on the failed AT&T/T-Mobile acquisition, Chairman Genachowski recently remarked "[w]e've staked our free enterprise system on having vibrant competition that leads to innovation that leads to better service that leads to better prices."<sup>89</sup> We agree.

Lock-up terms and conditions tying up significant portions of special access

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<sup>88</sup> As used in these proposals, a "volume purchase commitment" means a commitment by a customer to purchase an aggregate amount of service over a period of time from a price-cap LEC or group of affiliated price-cap LECs, whether based on quantity of circuits, bandwidth, or revenues. However, it does not include pricing based on the quantity of circuits or bandwidth ordered by a customer to a particular location or on a particular transport route, since such discounts may reasonably reflect economies of scale in providing higher capacity facilities.

<sup>89</sup> Comments of FCC Chairman Julius Genachowski, Silicon Flatirons Conference, Monday February 13, 2012.

demand have no place in a competitive marketplace, particularly when employed by price-cap LECs with dominant shares of the market. Level 3 believes these practices are pervasive, in which case they should be forbidden. The price-cap LECs may claim the practices are not pervasive, in which case there should be no objection to rules forbidding them. It is our hope that the roadmap provided above will allow the Commission to resolve what Level 3 believes to be the primary issue holding back competition in the special access marketplace quickly and effectively.

Sincerely,

A handwritten signature in black ink, appearing to read 'Michael J. Mooney'.

Michael J. Mooney

cc: Michael Steffen  
Sharon Gillett  
Deena Shetler  
Nick Alexander  
Elizabeth McIntyre  
Andrew Mulitz  
Eric Ralph  
Steven Rosenberg  
Richard Kwiatkowski  
Daniel Shiman